SCS Agency
Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Washington | Analyst: Jeani Brent | Bill Number: AB 2205

Related Bills: See Legislative History | Telephone: 845-3410 | Introduced Date: 02/19/98

Attorney: Doug Bramhall | Sponsor:

SUBJECT: Compton Economic Development and Job Creation Program

SUMMARY

This bill would provide that most of the tax incentives provided to the existing Los Angeles Revitalization Zone under the Revenue and Taxation Code would apply to taxpayers operating businesses within the City of Compton.

EFFECTIVE DATE

This bill would apply to taxable and income years beginning on or after January 1, 1998, and before January 1, 2004.

LEGISLATIVE HISTORY

AB 69, AB 82 (1997); SB 715 (Stats. 1996, Ch. 952), AB 1082 (1996); SB 712 (Stats. 1995, Ch. 494); AB 13132 (Stats. 1994, Ch. 756), AB 3121 (Stats. 1994, Ch. 606); AB 693 (Stats. 1993, Ch. 1216), AB 18 (Stats. 1993, Ch. 18) AB 38x (Stats. 1992, Ch. 17x).

PROGRAM HISTORY/BACKGROUND

California has five types of economic development areas that have similar tax incentives:

- Enterprise Zones,
- Los Angeles Revitalization Zone (LARZ),
- Local Agency Military Base Recovery Areas (LAMBRA),
- Targeted Tax Area (TTA), and
- Manufacturing Enhancement Areas (MEA).

The following table shows the incentives available to each of the economic development areas.

DEPARTMENTS THAT MAY BE AFFECTED:

____ STATE MANDATE ____ GOVERNOR'S APPOINTMENT

Board Position:	Agency Secretary Position:	GOVERNOR'S OFFICE USE
____ S ____ O ____ SA ____ OUA ____ N ____ NP ____ NA ____ NAR ___X_____ PENDING	____ S ____ O ____ SA ____ OUA ____ N ____ NP ____ NA ____ NAR DEFER TO ____________	Position Approved ____ Position Disapproved ____ Position Noted ____
Department Director Date Gerald H. Goldberg 3/19/98	Agency Secretary Date	By: Date

Types of Incentives	EZ	LARZ*	LAMBRA	TTA	MEA
Sales or Use Tax Credit	X	X	X	X	
Hiring Credit	X	X	X	X	X
Construction Hiring Credit		X			
Employee Wage Credit	X				
Business Expense Deduction	X	X	X	X	
Net Interest Deduction	X	X			
Net Operating Loss	X	X	X	X	

* NOTE: the LARZ expires December 1, 1998.

Assembly Bill 1040 (Stats. 1997, Ch. 605) removed the election provision from the Los Angeles Revitalization Zone sales or use tax credit and replaced it with a provision limiting the taxpayer to one credit with respect to qualified property that qualifies for the sales or use tax credit.

SPECIFIC FINDINGS

Under the Government Code, existing state law provides for the designation of the Los Angeles Revitalization Zone. Using specified criteria, the Trade and Commerce Agency (TCA) designated the LARZ from the maps received from the governing bodies of Los Angeles County and surrounding cities that suffered from civil disturbances in April and May 1992 based on:

- the specific geographic areas that suffered substantial property damage to businesses; and
- the supportive residential areas—areas of high-density unemployment adjacent to areas of depressed economic business activity.

The geographic areas that qualified and were designated as the LARZ were Compton, Hawthorne, Huntington Park, Inglewood, Lawndale, Long Beach, portions of Los Angeles, Lynwood, Pomona, Signal Hill, and portions of unincorporated Los Angeles County.

The TCA determines whether an approved map complies with, and remains in compliance with, these criteria. Any map determined to be out of compliance is void. The LARZ was designated in 1992 and is binding for five years.

Under the Revenue and Taxation Code, existing state law provides special tax incentives for taxpayers conducting business activities within the LARZ. These incentives include a sales or use tax credit, hiring credit, construction hiring credit, business expense deduction, special net operating loss treatment, and a net interest deduction for businesses that make loans to businesses within the LARZ. See Attachment A for a detailed discussion of each tax incentive, including a detailed discussion of the LARZ apportionment formula and how that formula differs from other economic development areas.

AB 2205 effectively would allow taxpayers operating a trade or business within the City of Compton the LARZ sales or use tax credit, hiring credit, business expense deduction, and special net operating loss treatment for an additional six-year period.

Implementation Considerations

The hiring credit defines "resident" by reference to Section 7101 of the Government Code. Section 7101 of the Government Code is contained in the LARZ chapter, which will be repealed by its own provisions on December 1, 1998. Thus, after that date, the reference no longer would be applicable. Also, the definition of "resident" contained in Section 7101 requires that the individual reside in the LARZ, which will no longer exist after December 1, 1998.

Technical Considerations

This bill raises the following technical considerations:

1. The bill would require that the hiring credit be reduced by the amount of certain other credits allowed. This provision, however, references the expired jobs tax credit and the repealed enterprise zone and program area hiring credits, which were replaced by the new enterprise zone hiring credit. In addition, this section would not require the hiring credit provided under this bill to be reduced by any allowed hiring credit provided under the new MEA or TTA provisions.

2. Although the provision requiring taxpayers to make an election was removed from the LARZ sales or use tax credit and replaced with a provision that only one credit is allowable for the qualified property, this bill would require the taxpayer to make an election, on the original return, if the expenditure qualifies the taxpayer for more than one credit. The change was made to assure that taxpayers are able to take advantage of the available credit. To address the same problem, this bill should be amended to replace the election language with a requirement that only one credit is allowable for the qualified property. See amendments 2 and 7.

3. The NOL provisions contain incorrect references. For example, the Personal Income Tax Law (PITL) refers to "bank or corporation" and "income year," and the Bank and Corporation Tax Law (B&CTL) refers to "person or entity" and "taxable year." Further, the PITL provisions reference the B&CTL general NOL and the B&CTL provisions reference the PITL general NOL. In effect, it appears that the PITL and B&CTL language were inadvertently swapped. Amendments 5 and 10 would make the appropriate changes. Please note that the term "bank" is unnecessary as the existing law definition of "corporation" includes "bank."

4. The NOL provisions also appear to be missing the provisions that would allow the NOL to be carried forward. Amendments 5 and 10 would include this necessary language.

5. The definition of “qualified property” under the sales and use tax credit is for purchases between 1998 and 2000 for the PITL, but between 1998 and 2004 for the B&CTL. Eliminating four years for personal income taxpayers would appear to be unintentional, since the PITL credit itself is allowed until 2004. Amendment 1 would change the 2000 date to 2004.

6. The language in the sales and use tax credit and hiring credit that provides for the carryover of the credit after the repeal of the section is duplicative of general tax law provisions and could be removed. Amendments 3, 4, 8, and 9 would remove this language.

7. The expiration date for the NOL provision is January 1, 2004. This date should be extended until December 1, 2004, to include all the 2004 calendar months for fiscal year filers. Amendments 6 and 11 would replace "January" with "December."

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

Revenue losses from this bill are estimated as follows:

Revenue Impact of AB 2205 Effective for Tax Years Beginning on and After January 1, 1998 (in millions)		
1998-9	1999-0	2000-1
($0.5)	($3)	($7)

Tax Revenue Estimate

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue losses under the Personal Income Tax Law and the Bank and Corporation Tax Law would depend on the ability of businesses to take advantage of the various state tax incentives offered by this bill combined with the relevant state tax liabilities of taxpayers claiming these benefits.

These order of magnitude estimates are based (except for the construction credit and net interest deduction) on a prior analysis for AB 82 (Villaraigosa), which would extend LARZ incentives beyond 1997 for all jurisdictions (total revenue loss of $18 million for the first year). Projections were based on relative percentages of taxable sales and assessed property values for Compton vs. all LARZ jurisdictions (approximately 5%), derived from State Board of Equalization reports.

BOARD POSITION

Pending.

ASSEMBLY BILL 2205 (WASHINGTON)
INTRODUCED FEBRUARY 19, 1998
Attachment A

LARZ TAX INCENTIVES

LARZ Sales or Use Tax Credit

The LARZ sales or use tax credit is allowed for an amount equal to the sales or use taxes paid on the purchase of qualified property for use in the LARZ and is limited to the tax attributable to LARZ income. Qualified property is defined as building materials used to replace or repair the business's building and fixtures within the boundaries of the LARZ, and machinery or equipment (excluding inventory) to be used by the business exclusively within the boundaries of the LARZ. In addition, qualified property must be purchased on or after May 1, 1992, and before the zone expiration date, which is December 1, 1998, as provided under the Government Code. Existing state law does not provide a maximum value of property that may be eligible for the LARZ sales or use tax credit.

LARZ Hiring Credit

A business located in a LARZ may reduce tax by a percentage of wages paid to qualified employees. A qualified employee must be hired on or after May1, 1992, and be a resident of the LARZ. At least 90% of the qualified employee's work must be directly related to a trade or business located in the LARZ and at least 50% must be performed inside the LARZ. The business mayclaim up to 50% of the wages paid to a qualified employee as a credit against tax imposed on LARZ income. The credit is based on the lesser of the actual hourly wage paid or 150% of the current minimum hourly wage. The amount of the credit must be reduced by any other federal or state jobs tax credits and the taxpayer's deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring credit.

LARZ Construction Hiring Credit

A business located in a LARZ may reduce tax by a percentage of wages paid to construction employees. A qualified construction employee must be hired on or after May 1, 1992, be a resident of the LARZ, and be hired by the employer to perform construction work in the LARZ. Construction work is any work directly related to the demolition, repair, erection, or renovation of a structure located within the LARZ. The business may claim 50% to 100% of the wages paid to a qualified employee as a credit against tax imposed on LARZ income. The actual percentage depends upon the date the employee was hired:

Date Hired	Applicable %
5/1/92 - 6/30/93	100%
7/1/93 - 12/31/93	75%
1/1/94 - 12/31/97	50%
After 12/31/97	0%

As is the hiring credit, the construction hiring credit is based on the lesser of the actual hourly wage paid or 150% of the current minimum hourly wage. Also, the amount of the credit must be reduced by any other federal or state jobs tax credits and the taxpayer's deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring construction credit.

LARZ Business Expense Deduction

A business located in a LARZ may elect to deduct as a business expense up to 100% of the cost of all qualified property purchased for exclusive use in the LARZ. The deduction is allowed in the taxable year in which the taxpayer places the qualified property in service. The election must be made on the original return. The basis of the property must be reduced by the amount of the deduction.

Net Operating Loss Deduction

A business located in a LARZ may elect to carry over 100% of the LARZ net operating losses (NOLs) to deduct from LARZ income of future years. The LARZ NOL is determined by computing the California business loss then applying a percentage (apportioning) to calculate the LARZ portion of the California loss.

Net Interest Deduction

A deduction from income is allowed for the amount of net interest earned on loans made to a trade or business located in the LARZ. Net interest is defined as the full amount of the interest less any direct expenses (e.g., commission paid) incurred in making the loan. The loan must be used solely for business activities within the LARZ and the lender may not have equity or other ownership interest in the LARZ trade or business.

Apportioning

For businesses operating inside and outside the LARZ, the amount of credit or net operating loss deduction that may be claimed is limited by the amount of tax or income attributable to the LARZ. For businesses operating in the LARZ, income is first apportioned to California using the same formula as that used by all businesses that operate inside and outside the state (property, payroll, a double-weighted sales factor). Income is further apportioned to the LARZ using a two factor formula based on the property and payroll of the business.

The LARZ apportionment formula differs from the formulas used for other economic development areas in two ways. First, the other formulas do not first apportion to California and then to the economic development area. Thus, the denominator for the apportionment formula for other economic development area tax incentives is world-wide income whereas the LARZ denominator is California income. Second, businesses in enterprise zones must apportion based on a four factor apportionment formula (property, payroll, a double-weighted sales). All other economic development areas, including the LARZ, use a two factor formula (property and payroll).

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2205
As Introduced February 19, 1998

AMENDMENT 1

On page 3, line 30, strikeout "2000" and insert:

2004

AMENDMENT 2

On page 3, strikeout lines 38 through 40 and on page 4 strikeout lines 1 through 6, and insert:

(c) If the taxpayer is allowed a credit for qualified property pursuant to this section, only one credit shall be allowed to the taxpayer under this part with respect to that qualified property.

AMENDMENT 3

On page 5, strikeout lines 31 and 32.

AMENDMENT 4

On page 10, strikeout lines 27 and 28.

AMENDMENT 5

On page 18, modify lines 17 through 39 and on page 19, modify lines 1 through 38, as follows:

d) A ~~bank or corporation~~ person or entity engaged in the conduct of a trade or business within the City of Compton.

(1) ~~(A)~~ A net operating loss shall not be a net operating loss carryback for any ~~income~~ taxable year and~~, except as provided in subparagraph (B),~~ a net operating loss for any ~~income~~ taxable year beginning on or after January 1, 1998, ~~and~~ shall be a net operating loss carryover to each following taxable year that ends before January 1, 2004, or to each of the 15 ~~income~~ taxable years following the ~~income~~ taxable year of loss.

~~(B) In the case of a financial institution to which Section 585, 586, or 593 of the Internal Revenue Code applies, a net operating loss for any income year beginning on or after January 1, 1984, shall be a net operating loss carryover to each of the five years following the income year of the loss. Subdivision (b) of Section 24416.1 shall not apply.~~

(2) For the purposes of this subdivision:

(A) "Net operating loss" means the loss determined under Section 172 of the Internal Revenue Code, as modified by Section ~~24416.1~~ 17276.1, attributable to the taxpayer's business activities within the City of Compton before January 1, 2004. The attributable loss shall be determined in accordance with the provisions of Chapter 17 (commencing with Section 25101) of Part 11, modified as follows:

(i) The loss shall be apportioned to the City of Compton by multiplying the loss from the business by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two.

(ii) "The City of Compton" shall be substituted for this state.

(B) A net operating loss carryover shall be a deduction only with respect to the taxpayer's business income attributable to the City of Compton determined in accordance with the provisions of paragraph (3).

(3) Attributable income shall be that portion of the taxpayer's California source business income which is apportioned to the City of Compton. For that purpose, the taxpayer's business income attributable to sources in this state first shall be determined in accordance with the provisions of Chapter 17 (commencing with Section 25101) of Part 11. That business income shall be further apportioned to the City of Compton in accordance with the provisions of Article 2 (commencing with Section 25120) of Chapter 17 of Part 11, modified as follows:

(A) Business income shall be apportioned to the City of Compton by multiplying total California business income of the taxpayer by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two.

(B) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in the City of Compton during the ~~income~~ taxable year and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used in this state during the ~~income~~ taxable year.

(C) The payroll factor is a fraction, the numerator of which is the total amount paid by the taxpayer in the City of Compton during the ~~income~~ taxable year for compensation, and the denominator of which is the total compensation paid by the taxpayer in this state during the ~~income~~ taxable year.

AMENDMENT 6

On page 19, line 40, strikeout "January" and insert:

December

AMENDMENT 7

On page 21, strikeout lines 7 through 15, and insert:

(c) If the taxpayer is allowed a credit for qualified property pursuant to this section, only one credit shall be allowed to the taxpayer under this part with respect to that qualified property.

AMENDMENT 8

On page 22, strikeout lines 39 and 40.

AMENDMENT 9

On page 27, strikeout lines 33 and 34.

AMENDMENT 10

On page 35, modify lines 30 through 40, on page 36, modify lines 1 through 40, and on page 37, modify lines 1 through 2, as follows:

(d) A ~~person or entity~~ corporation engaged in the conduct of a trade or business within the City of Compton.

(1)(A) A net operating loss shall not be a net operating loss carryback for any ~~taxable~~ income year, and, except as provided in subparagraph (B), a net operating loss for any ~~taxable~~ income year beginning on or after January 1, 1998, ~~and~~ shall be a net operating loss carryover to each following income year that ends before January 1, 2004, or to each of the 15 ~~taxable~~ income years following the ~~taxable~~ income year of loss.

(B) In the case of a financial institution to which Section 585, 586, or 593 of the Internal Revenue Code applies, a net operating loss for any income year beginning on or after January 1, 1984, shall be a net operating loss carryover to each of the five years following the income year of the loss. Subdivision (b) of Section 24416.1 shall not apply.

(2) For the purposes of this subdivision:

(A) "Net operating loss" means the loss determined under Section 172 of the Internal Revenue Code, as modified by Section ~~17276.1~~ 24416.1, attributable to the taxpayer's business activities within the City of Compton before January 1, 2004. The attributable loss shall be determined in accordance with the provisions of Chapter 17 (commencing with Section 25101~~) of Part 11~~, modified as follows:

(i) Loss shall be apportioned to the City of Compton by multiplying total loss from the business by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two.

(ii) "The City of Compton" shall be substituted for "this state."

(B) A net operating loss carryover shall be a deduction only with respect to the taxpayer's business income attributable to the City of Compton determined in accordance with the provisions of paragraph (3).

(3) Attributable income shall be that portion of the taxpayer's California source business income which is apportioned to the City of Compton. For that purpose, the taxpayer's business income attributable to sources in this state first shall be determined in accordance with the provisions of Chapter 17 (commencing with Section 25101)~~ of Part 11~~. That business income shall be further apportioned to the City of Compton in accordance with the provisions of Article 2 (commencing with Section 25120) of Chapter 17~~ of Part 11~~, modified as follows:

(A) Business income shall be apportioned to the City of Compton by multiplying total California business income of the taxpayer by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two.

(B) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in the City of Compton during the ~~taxable~~ income year and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used in this state during the ~~taxable~~ income year.

(C) The payroll factor is a fraction, the numerator of which is the total amount paid by the taxpayer in the City of Compton during the ~~taxable~~ income year for compensation, and the denominator of which is the total compensation paid by the taxpayer in this state during the ~~taxable~~ income year.

AMENDMENT 11

On page 37, line 4, strikeout "January" and insert:

December